

Q2 + 5 "Problems & Applications"

Incentives - effort required
make effort consistent
with rewards

positive → reward
negative → penalty

Unintended consequences

- wealth tax on cars \times % Blue book value
- encourages \rightarrow older cars - emissions \uparrow
- fleet age \uparrow 1.1 years
- EPA "Mobile 6" - emissions \uparrow

Methodology

-normative - "should" - ethics

-positive - "as it is" - efficiency

Health - normative - wealthy
country - should be universal!

* positive - universal coverage increase
GDP

- health outcomes + cost
- entrepreneurial activity
- risk taking

Basic axioms of behavior

- 1 More is better than less
 - non-satiation axiom
 - free disposal
- 2 Rank alternatives - ordering axiom
 - X preferred to Y $X \succ Y$
 - or $Y \succ X$
 - or $X \sim Y$ indifferent

3 Transitivity

If $x \succ y + y \succ z$ then
 $x \succ z$

Incentives work -

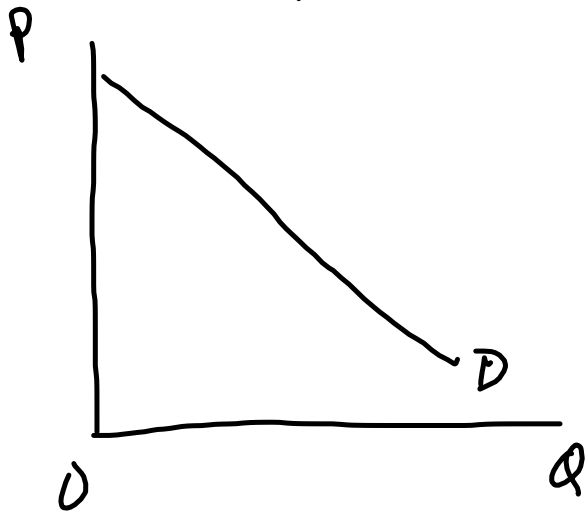
Non-satiation axiom

Rank (complete ordering)

Transitive

Model → incentives change behavior

Law of Demand. $P \uparrow \rightarrow Q \downarrow$ negative



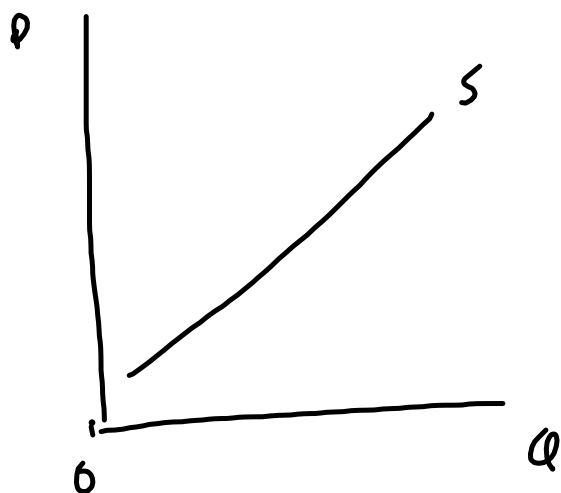
Hypothesis

- more Q lower price

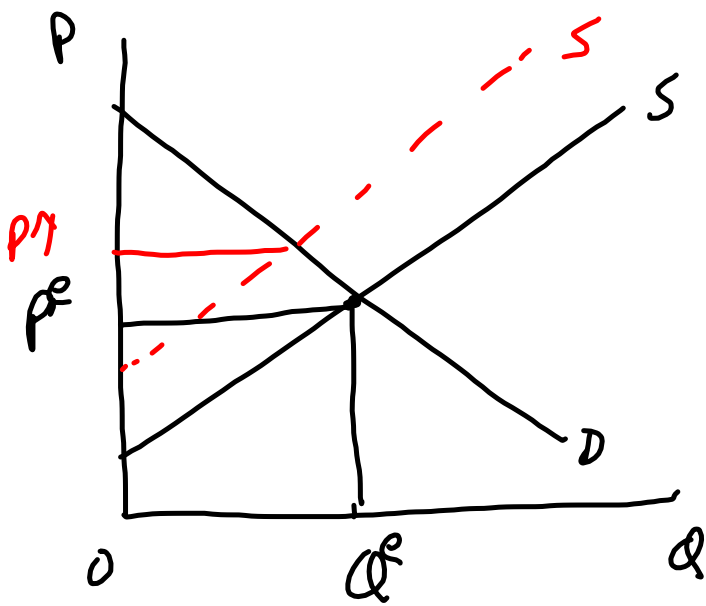
- less Q raise P

Data? - prices & quantities

Law of supply $P \uparrow \rightarrow Q \uparrow$ positive

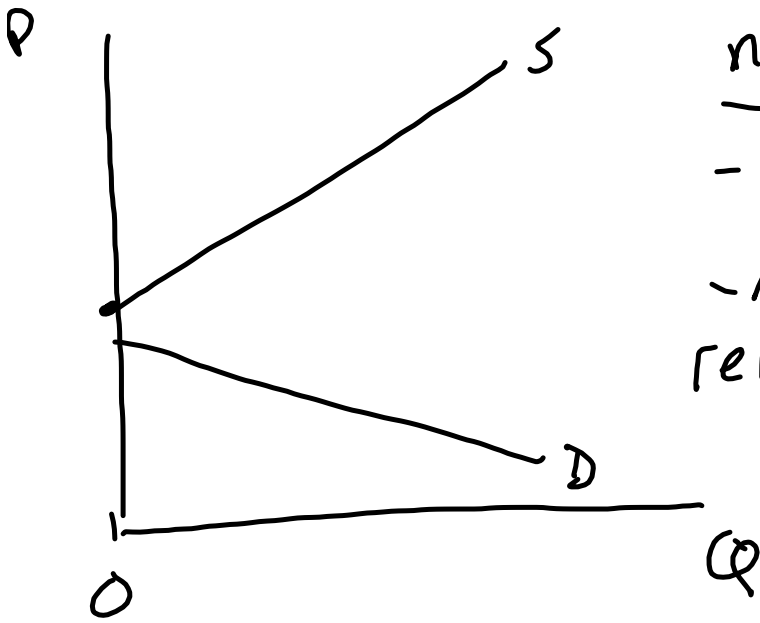


Market - D + S



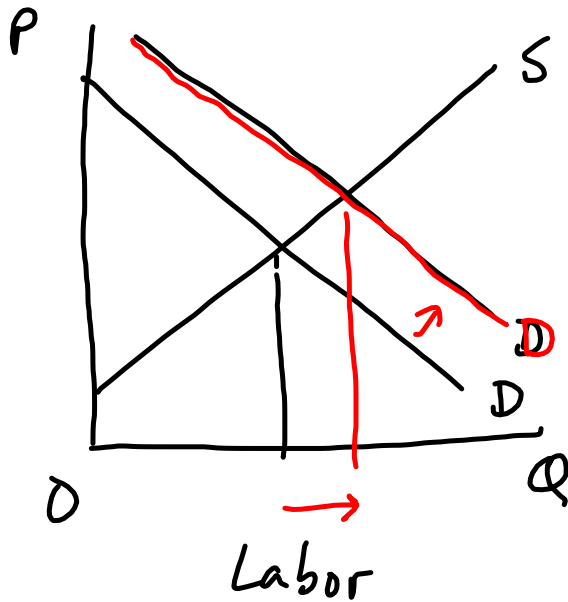
at P^e
 $Q_D = Q_S = Q^e$

Model of market



no market
- no Demand
- no Supply at relevant price

"Shortage of labor" .



wages ↑

why wages ↑?

"surplus of x"

prices ↓

Models - abstract from reality

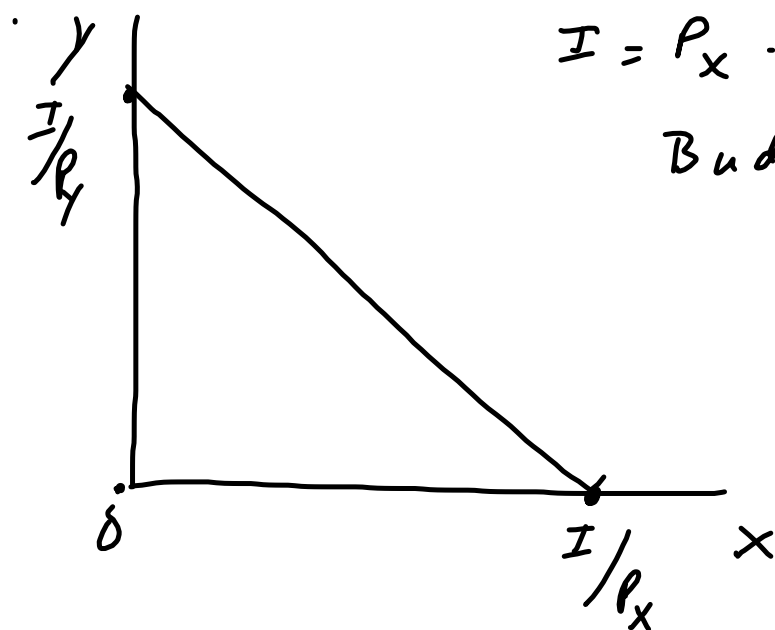
to abstract → assumptions
are assumptions valid?

do assume away problem? - if so
assumption not valid.

- "World is flat" - surveyer

Sniper 2760 meters not flat

Coriolis force



Economy wide equivalent

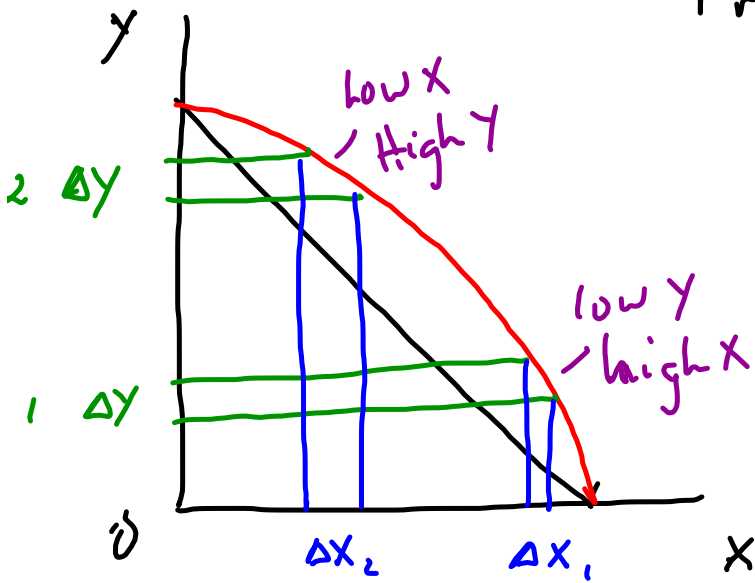
Production

possibility

frontier

(PPF)

X & Y use
different
inputs



opp cost Δy

Diminishing Returns

Fig 2
Chapter 2